

## COOPERATIVE STRUCTURES

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Cooperatives are one of the four broad classifications of doing business in our free competitive society. Their organizational structure varies in the United States from one geographical area to another and by services offered. Cooperatives differ one from another as people differ one from another because cooperatives are organizations of people. Probably the two most important variations in organizational structures of agricultural cooperatives are federated and centralized, with stock or membership being a second major difference that will be discussed in the time devoted to financing.

Cooperatives are commonly organized and structured to meet a need of people; therefore, the resulting firm often is structured or organized in a manner that the organizers believe will best fit their need. The cooperative structures are also strongly influenced by the resources available to the organizers.

The wide variations in cooperative structures reflect people served, areas served, services or marketing functions performed, method of financing, type of membership contract, characteristics of the membership and even the geographical location.

Due to the limitations of time, only a select few variations in structures will be discussed in this paper. The classification of cooperatives by their variations in structure can become somewhat complicated

as there is considerable overlapping in the various aspects of the different structures.

#### CORPORATE VARIATIONS

Cooperatives vary as to their being incorporated or unincorporated. It is the opinion of the author that the values of incorporation compare favorably with the inherent risks of unincorporation and that all business ventures should be knowledgeable of the special statutes that permit incorporation and take advantage of them. However not all cooperative leaders agree with this opinion; thus, there are many unincorporated groups that call themselves a cooperative. (Future discussion will be found on this point under the emerging cooperatives section.)

Not all cooperatives are incorporated under the same section of the Ohio Revised Code. Chapter 1729 of the Ohio Revised Code provides for agricultural cooperatives that market or sell farm products. Section 1729.02 states the broad range of services agricultural cooperatives can be engaged in and Section 1729.28 expands the original statute to provide for consumer cooperatives (the author knows of no Ohio consumer cooperative organized under Section 1729).

The three most recent issues of the "Directory of Ohio Cooperatives" gave the charter designation of each cooperative. From a quick review of this reference one can see that many Ohio cooperative elevators are incorporated under the General Corporation for Profit Chapter 1701.

Rural Electric Cooperatives are incorporated under Chapter 1702 -- Corporations Not For Profit. Farm Credit and Federal Savings and Loan Associations are incorporated under Federal Statutes while credit unions have state charters.

Most mutual insurance companies have a special chapter 3901; however, Nationwide Mutual Automobile Insurance Company and Grange Mutual Casualty Company are incorporated under General Corporation 9607-2. Some firms, such as Mid-States Wool and Universal, are classified in Ohio as foreign corporations as they are incorporated under statutes of other states and operate in Ohio.

#### FINANCIAL STRUCTURE

Another way in which cooperatives differ relates to the way membership is obtained. Two basic types relate to the financial structure and are commonly designated stock or non-stock. In the stock cooperative, membership is evidenced by the ownership of stock which is a part of the cooperative's equity capital. There are different classifications of common stock such as A, B, X and Y. One of these classifications (e.g., common A) being ownership, voting or membership stock. The bylaws and code of regulation will designate within the limits of the state statute under which the cooperative is chartered the numbers of shares of voting shares one member may own. Kentucky law permits one member of the cooperative to have up to 49 percent of the controlling votes while most state cooperative statutes permit only one vote per member or in some states no more than five percent of the total vote based on volume.

In a non-stock or membership cooperative, ownership or voting right is evidenced by a membership card or membership certificate. Ohio law (1729) requires that each member shall be issued a membership card and that no member of a membership cooperative may have more than one vote. Non-stock or membership cooperative may have free and automatic membership or it may have a high cost membership fee with the membership fee becoming

the basis of the cooperative's equity capital. Usually the membership contract is valid as long as the member meets the membership qualifications as set forth in the cooperative's corporate papers. Some cooperatives require a periodic membership fee, such as annually. Membership in a membership cooperative can be easy and almost automatic, such as establishing an account in a Federal Savings and Loan, or endorsing the check received from the cooperative for the products delivered to the cooperative or requesting electrical service. Most REC's and some mutual insurance companies require a membership fee before the services of the cooperative can be obtained.

There are agricultural cooperatives that have a membership fee requirement for members while their financial structure is based on stock.

#### OPEN AND CLOSED MEMBERSHIP

This variation of cooperative structure is possibly the oldest. The Rochdale Pioneers drew upon the successful ideas of earlier cooperatives, thus, they required those desiring membership to present themselves, their spouse and a sample of their labor before the leadership of the cooperative who approved all new members for the cooperative. The Ohio Cooperative Marketing Act, Chapter 1729, provides that the board of directors prohibit the transfer of common stock of the association to persons not engaged in agricultural production. The board of directors also are responsible for seeing that the members meet the membership requirements as set forth in the statute, articles of incorporation and bylaws or code of regulations.

There are many closed membership cooperative elevators in Ohio. Representatives of these firms will quickly tell you they are not a cooperative and that they do not associate with cooperatives. For the most part, these

firms were organized as cooperatives, incorporated under Chapter 1701 and have drifted from a cooperative to the ownership and control of a few individuals. This is a real danger for farmers interested in investing in cooperatives. The causes are greed and member apathy. This is not a situation confined to agricultural cooperatives but is quite common also in savings and loans and mutual insurance.

This variation should not be confused with a more recent variation commonly referred to as "member only" which refers to the allocation of patronage and IRS Section 521 and will be discussed later.

Limited or closed membership cooperatives in this paper refer to those cooperatives that have limited the number of members or the total volume of business the cooperative will receive. As a rule, non-members are not served. Prospective members may ask to be placed on a waiting list for membership. As pointed out above, REC's, PCA's, BC's, FLB's, savings and loan, credit unions and mutual insurance companies usually serve only members.

The closed membership cooperative often has a contract with the member for all of his business, either marketing, supply or service and a requirement for financing his cooperative.

The closed cooperative has been most popular in service, credit, insurance and marketing and appears to be gaining popularity in other types of cooperatives.

The open membership cooperative accepts anyone that applies for membership and meets the requirements of the cooperative's charter. The truly open membership cooperative will have no requirements that members patronize or finance the cooperatives.

Some state statutes authorizing the incorporation of agricultural cooperatives do have provisions that authorize or in some states may require boards of directors to dismiss from membership persons who have not used their cooperatives for a period of one or two years.

#### MEMBER ONLY

This variation is directly related to the IRS tax classification and refers to those cooperatives that do not qualify under Section 521 or the provisions of Subchapter T. The law says in part, "farmers, fruit growers or like associations that qualify under IRS Section 521 must afford equality of treatment to all patrons" and is not permitted to discriminate between members and non-member patrons in any way.

A member only cooperative does not qualify for IRS treatment under Section 521. This term, "member only," refers to the allocation of patronage refund which is paid only to members. As a rule these members are farmers but in some cases non-farmers are permitted to join as associate members without voting rights and thereby receive patronage refunds on the business they do with the cooperative.

#### FEDERATED AND CENTRALIZED

Probably the most important variation in organizational structures of agricultural cooperatives are federated and centralized.

The federated cooperative is often referred to as a "grass roots" type organization because individual farmers are owners and members of a local cooperative that in turn owns the regional. In a federated system, the farmers' local cooperative joins with other cooperatives to organize and own another cooperative with each of the farmer's local cooperatives being a member of the federated cooperative. Individual farmers are not

members of resulting federated cooperatives which is usually a regional. Only cooperatives, not farmers, are members of a federated cooperative. Federated cooperatives may join with other cooperatives, federated, local or centralized, to organize, and own another federated cooperative,

In a centralized cooperative, farmers are members of the centralized and are not members or direct owners of the local cooperative that may serve them. As an example, let us use a centralized that serves the geographical area of a state with an outlet in each county of the state. Farmers who own this centralized are members or owners of the statewide or regional centralized cooperative and may be elected to serve as a director of the centralized but not of the local as the locals are, in fact, branches of the centralized and are owned and controlled by the centralized cooperative.

Among the advantages of the federated type are:

- A greater involvement of farmers in the control and management of the local cooperative that serves them.
- A local cooperative that owns a federated will return to its local farmer-owners the profits from their own cooperative operation plus its share of the federated's earnings,
- Farmers will recognize the need to provide adequate financing and commitment for their cooperative to be successful.
- Farmers elect the directors to manage their local cooperative.
- Directors of their local cooperative live closer to the individual member.

Among the advantages of the centralized type are:

- Locals obtain all supplies and market all products through the centralized thus assuring volume and quality control,

- Management of locals is not under direct pressure of local members.
- Management and marketing decisions can be made quickly.
- Management has more opportunity to advance within the cooperative.
- All members of the centralized share equitably in the patronage refunds of the total cooperative system.
- There is less director and annual meeting expense.
- Prices are essentially the same at all branches.

#### EMERGING COOPERATIVES

A variation that is receiving more attention by governmental agencies is emerging cooperatives. Emerging cooperatives are defined as a new cooperative that is not affiliated with an existing cooperative. While emerging cooperatives are not exclusively concerned with problems of low income people, a high proportion are. Emerging cooperatives are found in both urban and rural areas. The emerging cooperative in contrast to the new unit of an established cooperative has no organization to look to for support.

The emerging cooperative may have any of the above variations in structure.

#### SUMMARY

It is important that cooperative employees, management and members understand their own cooperative. Too often cooperatives and cooperative employees have experienced difficulties because all interested parties did not have the same understanding of the cooperative. There are, for example, vast differences in the positions of county manager for a centralized and for a federated. The benefits members receive differ also as members of a centralized will receive patronage refunds only if the total system prospers.



On the other hand members of a local that owns the federated will receive patronage refunds only if their own local cooperative is profitably operated.

Each of these variations in structures has its advantages and disadvantages. The popularity of one type over another in a geographical area can often be traced to the philosophies of early cooperative leaders.